

CEMS – The Global Alliance in Management Education

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Flatout Technologies’ Internationalisation Strategy

Work Project based on the Business Project “Flatout Technologies:
Market Entry Strategy in the Czech Republic”

Ana Luísa Sousa Leal de Castro Mendes

MSc in Management student number: 1216

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1. Context of the Business Project

1.1. Company Overview

Flatout Technologies (Flatout) is an Austrian start-up in the Smart Home market. A Smart Home can be defined as “a home or building that is equipped with a special connected platform enabling its occupants to remotely control and program an array of automated electronic devices” (Levy, Taga, Saadoun, & Riegel, 2012). This market is booming, with a growth rate of 24.6% and projected 2 million installations until 2019 (Flatout Technologies, 2014). Still in its infancy, the market is relatively unstructured. For instance, each company tends to have its own proprietary solution and different data transmission standards. This leads to compatibility issues on the hardware and software side, respectively. Moreover, available solutions often lack simplicity and usability for the user.

Flatout defines its unique selling proposition as “Smart Home as a service” (Flatout Technologies). The company developed a white-label Smart Home solution centred on their cloud-based operating system – the FlatOS – that is sells to business customers. Hardware production was outsourced, as it was not their core capability. This operating system runs in the (Flat)Cloud where all information from the devices connected to the FlatOS is stored. Flatout carries out all the operative tasks, leaving the business customer simply to market and sell the product to the end-consumer. This is the company defines itself as offering a service (Flatout Technologies).

Flatout’s competitive advantage stems from its ability to solve the previously mentioned issues in the Smart Home market. The FlatOS supports several communication standards and, as such, can communicate with different electronic devices (regardless of brand) within the home. Examples of connectable devices are lamps, coffee machine, TV, among many others. It can then be described as universal, since it is compatible with different proprietary solutions and data transmission standards.

Further adding to the compatibility argument is implementation of an open system that allows developers around the world to create apps for FlatOS. This is key to keep adding value to the platform in the long run. Another key advantage is the usability of the platform. It has an appealing design and is highly intuitive to use. Finally, being a white-label solution means it is highly flexible and customizable to the needs of individual business customers. Everything from software to hardware can be customized and rebranded to fit the company’s requirements.

1.2. The Business Project Challenge

Flatout is still a very young firm – in fact, during the elaboration of the Business Project they had yet to start commercialization of the solution. As they wish to internationalize from inception, several potential customers are being sought out and briefed on the company and its offering. One of these, Vodafone, asked Flatout to prepare a proposal. The idea was to enter in the Czech Republic and use it as a pilot market for a future European rollout. The Business Project aimed at helping Flatout in this task and providing it with useful insights on a possible market entry strategy.

The report was divided in three phases. In the first, the market and the opportunity it presented were assessed. Both macro- (using PESTLE) and microeconomic (analysing competitive environment and market trends) conditions were evaluated. The opportunity was then gauged using a SWOT and doing a matching and converting analysis. Findings supported the decision to enter the market – the macroenvironment situation is stable, competition is limited and market trends are favourable to product adoption.

In the second phase the market entry strategy was created. This included market segmentation and the development of a marketing mix using the 4P's framework. To maximize probability of adoption, segmentation focused on identifying consumers with a predisposition to buy the product. These were defined as early adopters of innovation, since the Smart Home market is still relatively new. Product offering was suggested to remain relatively similar to the one developed for Austria. Only the use cases adapted to Czech consumers were introduced to fine-tune and create more valuable product bundles.

Regarding price, different approaches were taken for hardware and software products. Hardware was priced close to break-even since this is not a core area for the company and lower prices will help incentivize trial. Value-based pricing with a ladder approach was used to price software in order to maximize rent potential. Suggested distribution channels in the entry phase were limited to test both the product and the strategy prior to a full country rollout. Finally, promotion focused on the creation of a communication campaign for the initial stages of product introduction. Its ultimate goal is to incentivise product trial, mainly by educating consumers about Smart Homes and their benefits.

The third and final phase evaluated the most likely future risks Flatout could face after entering the Czech market and created a contingency plan for them. The most worrisome are the entry of international competitors with a similar business model and having faulty functioning devices (not compliant with European Union quality regulations).

2. Flatout Technology's Internationalisation Strategy

During the development of a market entry strategy for the Czech market entry mode choice was not analysed. Flatout had already decided on this element of the strategy and, as such, this topic was never explored in the Business Project. However, this choice can have an impact on the firm's international operations as well as performance, and consequently success. It is therefore important to have a clear and detailed reasoning backing up this decision, to assure the company is maximizing its value creating potential.

2.1. Flatout as a Born Global Firm

Growing globalization of markets and technological advances in information and communication platforms have led to the creation of a new typology of firm – born globals. These can be defined as “business organizations that, from or near their founding, seek superior international business performance from the application of knowledge-based resources to the sale of outputs in multiple countries” (Knight & Cavusgil, 2004).

Flatout fits this description. Despite having been created only a year ago it had the desire to internationalize its operations from inception. It started by using international suppliers for the hardware in order to get the best prices and offer clients competitive device prices. Flatout's ultimate goal is to find a niche to settle in as soon as possible, as the entry of big technology players like Apple or Google is inevitable (Innovation Consulting, 2014). In fact, it is common for born globals to follow this niche strategy (Crick & Spence, 2005). This is partly what fuels their desire to internationalize so soon and so quickly – they want to recover initial development expenditures and create a revenue flow to fund on-going and future development activities (Burgel & Murray, 2000).

Born globals' smaller size gives them more flexibility, helping them to successfully internationalize at an early stage, despite having scarce financial, human and tangible resources. Their success in international expansion hinges on intangible knowledge-based capabilities instead of the traditional leveraging of tangible resources (common of older, more established firms) (Knight & Cavusgil, 2004). For Flatout, this refers to their unique software development know-how – which is the basis for the company's competitive advantage.

2.2. Internationalisation of Born Globals

Firms in high-tech markets have a tendency for faster internationalisation and usually choose different entry modes from those operating in low-tech markets. This means Flatout

needs to be able to react quickly and take advantage of rising opportunities. Within the fast-paced technology market having a first mover advantage can help companies undercut competition and greatly influence their success (Crick & Spence, 2005). In fact, having a first-mover advantage was one of the major opportunities identified in the Business Project regarding a possible entry in the Czech Republic.

Traditional stage models of internationalization point to firms engaging in international expansion in a systematic and sequential way. The idea is that knowledge and experience on how to manage foreign operations is slowly gained. In technology markets this assumption no longer holds true because of the fast-paced environment that surrounds it. An innovative firm like Flatout's internationalisation is often based on entrepreneurial culture, opportunistic strategies and short-term goals (Crick & Spence, 2005).

2.3. Analysis of Entry Mode Choice Determinants

Hill, Hwang and Kim's eclectic theory of the choice of international entry mode advises taking into account a number of trade-offs when choosing an entry mode (see *Appendix 1*). According to this framework, each entry mode implies different degrees of control, commitment of resources and dissemination risk. Control refers to the authority the firm will have over decision-making, resource commitment to resources that will bear a cost in case of redeployment and dissemination risk to risk of firm-specific know-how being dispersed by a licensing or joint venture partner (Hill, Hwang, & Kim, 1990).

Most research about internationalization and the determinants of entry mode choice have focused on firms that follow more "traditional" paths. These are usually bigger multinational companies, whose characteristics differ greatly from born globals. As such, being aware of its limitations, Hill, Hwang and Kim's framework will be applied, as it appeared to be the one that integrated the most relevant determinants of entry mode choice.

This framework points to three broad groups of variables that influence entry mode choice – strategic, environmental and transaction-specific. Each group will be explored in greater detail over the next few paragraphs.

Strategic Variables

Strategic variables will determine the level of control the firm wants to have over foreign operations.

Flatout is trying to implement a multi-domestic strategy. Even though so far the firm has had a country-by-country approach, it wants to create clusters of European countries. The

idea is to group countries with similar characteristics, namely geographic proximity, languages, purchasing power, culture, lifestyle/mind-set and pricing of relevant industries. Several potential clusters emerge from this classification – examples could be the *Dach* (Germany, Austria, Switzerland) or Southern Europe (Italy, Spain, Portugal) clusters. For Czech Republic, for instance, use cases were defined according to consumers' perceived most useful functionalities so that product bundles were adapted to local consumer needs. Firms following a multi-domestic strategy will need a lower degree of control over foreign operations, as sales and marketing efforts will need to be managed locally.

Being relatively new, the Smart Home market can be described as quite dispersed. Due to growing globalization and improvements in communication technologies, entry into technology markets tends to be easier. As can be seen from Flatout's example, barriers to entry are relatively low and older or larger incumbents may not have an advantage over new entrants. This means global strategic coordination is not a concern at this point and lower degree of control of foreign operations is thus needed. Competitors are globally dispersed and several countries are still unexplored. This situation could change in the near future, with an evolution towards a more mature market. At that point, this factor should be reassessed (Hill, Hwang, & Kim, 1990).

Environmental Variables

Exogenous environmental variables will affect the entry mode choice through the impact they have on resource commitment and strategic flexibility.

The first, country risk, is measured by looking at political, ownership/control, operations and transfer risk. The general political situation in Czech Republic is stable. Furthermore, the government does not impose barriers to the entry of foreign firms. In fact, Czech Republic scored quite well on the *ease to do business* indicator, well above Europe's average (World Bank, 2013). Even though Czech currency is not the Euro, being part of the European Union creates some security when it comes to transfer risk. Nevertheless, exchange rates fluctuate which may create some exchange rate risk. Overall, country risk can be concluded to be low meaning high resource commitments may be attractive.

Another relevant factor is location familiarity. Since both countries are European Union members, one can assume they share some elements when it comes to economic systems. Culturally speaking they are quite similar according to Hofstede's cultural dimensions (Hofstede). The most relevant variation pertains to the strikingly different scores in power distance (see *Appendix 2*), showing Czech Republic as a more hierarchical society. The two

countries can be said to be moderately similar, which points to Flatout favouring a medium resource commitment.

Uncertainty towards future demand conditions may also affect willingness of the firm to commit resources and limit its strategic flexibility. A thorough assessment of the Czech market in the Business Project pointed to it having high potential. There is a favourable macroeconomic and competitive situation as well as market trends. Nevertheless, considering the Smart Home market is still in its infancy, future demand conditions are still somewhat unpredictable. For instance, unexpected events can suddenly turn things upside down – an example being the bankruptcy of Lehman Brothers in 2008 and the global chaos it created. Therefore, some uncertainty regarding demand should be perceived and, as such, medium resource commitment entry modes should be favoured.

Finally, competitive conditions in the Smart Home market are volatile. By definition technology-related markets evolve at a very fast pace, which means companies need to be highly adaptable and flexible to survive. In the particular case of the Czech Republic there is an added factor – the imminent threat of international competitors. Due to low entry barriers they are bound to enter the market in the near future, especially considering the positive indicators seen when in the market assessment. As such, Flatout should abstain from making resource commitments in order to maintain its strategic flexibility (Hill, Hwang, & Kim, 1990).

Transaction-specific variables

Any entry mode that involves the inclusion of a third party will increase the probability of dissemination risk and thus increase transaction costs. Even though the creation of a comprehensive contract might limit this risk, uncertainty will never be fully eliminated due to the incomplete nature of real-world contracts.

Being a born global, Flatout's survival and success hinges on its ability to leverage unique software development capabilities. Loosing this know-how would mean losing its competitive advantage, probably compromising Flatout's future survival. Due to its innovative nature the value creating potential of this new cloud-based operating system is enormous. As such, the company will probably look for an entry mode that minimizes dissemination risk (if transaction cost savings exceed resource commitments and bureaucratic costs).

Flatout's solution has been developed with the goal of creating an ecosystem. Several different functionalities are embodied in the solution and, in the future, the goal is for the

diversity of functionality to grow. This is why Flatout has created an open system and offers interfaces for external developers to create new apps that will complement the FlatOS. The goal is to make the product increasingly hard to imitate by increasing its complexity. Nevertheless, the current essence of the product is defined in a code. It is currently stored in the company's cloud to prevent access by external parties. This means, however, the tacit component of this know-how is not that high and the knowledge could in theory be transferred. This means an entry mode that minimizes dissemination risk will be once again preferred (Hill, Hwang, & Kim, 1990).

2.4. Entry Mode Choice

The problem now is that different variables may point to contrary choices of entry modes. Strategic variables indicate the company does not need a high degree of control over foreign operations and should thus choose a non-equity entry mode. Environmental variables point in multiple directions regarding entry mode choice, as different factors can be used to justify different levels of resource commitment. Finally, transaction-specific variables indicate the firm should be highly concerned about dissemination risk and should therefore choose to assume as much control as possible over foreign operations.

In order to make the best choice, it is necessary to have a critical view of these variables and assign them relative weights. The ultimate goal is to choose the entry mode that maximizes Flatout's value creating potential. Several researchers have concluded entry mode choice should be based on the level of commitment a firm is willing to make to its foreign operations. Two main considerations have been said to influence this choice for born globals. First, these firms' dependence on unique knowledge-based capabilities makes knowledge exposure or dissemination a critical risk. This means these companies will prefer high-commitment entry modes to prevent sharing knowledge with third parties. Second, their lack of resources may prevent them from engaging in high-commitment entry modes (as they usually require high investment) (Efrat & Shoham, 2013).

Coming back to the entry choice determinants previously identified, transaction-specific variables emerge as the priority for Flatout. This means that a mode of entry allowing high control and minimization of dissemination risk would be chosen. The best mode of entry to achieve these objectives is creating a wholly owned subsidiary. However, a born global's specific constraints regarding lack of resources renders this option virtually impossible. Even though this dilemma may appear unsolvable, the solution is to compromise. As such, the next best option is for Flatout to establish a partnership in order to successfully

internationalise operations. It gives the company medium control over foreign operations, encourages medium resource commitment (thus maintaining some strategic flexibility) and incorporates medium dissemination risk.

Given what has been previously said about born globals, leveraging networks and forming partnerships may not be a choice but a vital necessity. Technology-intensive industries usually go hand in hand with collaborative strategies. Partnering with an established company in the local market would allow Flatout to leverage their reputation and experience with the local market. A new product like Flatout's will need a high level of support for the end-consumer in order to be successful (Burgel & Murray, 2000). This is better achieved through the recourse of a recognized and established company, who consumers already know and trust.

This is not that dissimilar to what Flatout actually decided to do. The original idea was to target end-consumers directly, but they soon realized it would be extremely difficult. A completely new product and no resources to effectively market it to consumers would most likely have led to failure (Innovation Consulting, 2014). What Flatout eventually decided to do was approach business customers, namely telecommunication providers, and use a hybrid entry mode – a mix between licensing and partnership.

On the one hand, it can be described as licensing since it is a white label solution rebranded and customized to fit the customer's brand. Furthermore, sales and marketing efforts are fully managed and decided by the customer. On the other hand, it can also be described as a partnership due to the "Smart Home as service" strategy. Flatout maintains control of the (Flat)Cloud and manages all the operational tasks (in order to maintain control of the product code and prevent its dissemination). It also offers added services, in the form of trainings and consulting on how best to sell the product.

Flatout has already implemented this entry mode with A1 in Austria. Learning effects on how to manage relationships with their business partners might be easier and less costly to achieve in their domestic market (Burgel & Murray, 2000). This means that it might make sense for Flatout to enter the Czech market using the same entry mode. It is congruent with the conclusions of the framework and the experience with A1 will help Flatout to manage the relationship with Vodafone better. In the future, when market conditions or firm-specific conditions change entry mode choice should be reassessed to make sure it is still the one that creates the most value for Flatout.

3. Reflection on Learning

3.1. Previous and New Knowledge Applied

The way we approached price for hardware was based on some concepts I had previously learned on a *Negotiation Analysis* course at Nova. We based our hardware prices on the structure of a negotiation model. By calculating Flatout's and Vodafone's reservation price we were able to come up with the zone of possible agreement and provide Flatout with valuable information for the price negotiation. The promotion strategy was also developed based on knowledge I had previously acquired, this time on an *Integrated Marketing Communications* course at Nova. The basis of a communication plan was developed using the structure provided in this course, namely identifying target audience, positioning, communication objectives, creative strategy and IMC/media strategy.

For pricing the software, on the other hand, we ended up employing a concept I had never used before. We developed a price ladder to be able to capture consumers' willingness to pay and create long-term profitability for Flatout. It is a win-win situation, since both Flatout and Vodafone will earn higher revenues with this price model. Finally, even though I knew and had applied a SWOT analysis many times before, I had never used a matching and converting approach. Matching is used to find competitive advantage by comparing strengths and opportunities, while converting refers to the process of converting weaknesses and threats into strengths and opportunities. This analysis provided us with valuable insight for the business project, helping us to create a better market entry strategy.

3.2. Personal Experience

I believe one of my greatest strengths is my ability to work in a team. I believe I do my best work when working together with colleagues and having valuable discussions about how to approach a project. I usually try to maintain a positive spirit and motivate the team on moments of pressure. I am usually able to maintain a clear head and develop an action plan to tackle issues, prioritizing tasks according to time constraints. I also believe I am reliable since I do all my work on time and to the best of my ability.

One weakness I need to work on is time management. Even though I always deliver my results within agreed deadlines, I sometimes do not do the most efficient allocation of my time. I have a tendency to postpone and do tasks under more stress and time-constrained conditions. I have become so accustomed to working under stress and time-pressure that these are two of the things that work best to motivate me. Nevertheless, I believe I should

work in this in the future in order to achieve a better balance in my life. I need to find other ways to motivate myself and complete my tasks in a more efficient way. I usually try to create a schedule with intermediate goals than I can achieve to improve my motivation.

Another weakness is taking the time to listen to my team members. I sometimes get too carried away by my thoughts and do not let people fully explain their point of view before I intervene. While I do not consciously do it, I think it started as a coping mechanism for my forgetfulness. I sometimes feel that if I do not say what I am thinking immediately the thought will go away. In order to improve on this I think the best option would be to start writing things down so that I can simply wait and then explain my point of view.

3.3. Benefit of Hindsight

Albeit I was sceptical in the beginning, I was very happy to work with a start-up. Young companies (particularly in the technology industry) need to identify and act very quickly on opportunities. They often lack, however, the resources to do all they would want to do. As such, partnering with a university creates a situation beneficial to all – the company benefits from temporarily enlarging its workforce, so to speak, and students benefit by learning from a real company and seeing the impact of their work.

Working with a start-up with people close to our age allowed us to have a closer relationship with the company and business advisor. He was always prompt to answer any questions and provided us with all the information we needed. This allowed more valuable results to be reached in the end and a bigger motivation on our part to achieve them. We perceived our insights to be of critical importance to Flatout, since the company was going to present its final proposal to Vodafone at the end of the semester.

There were, nevertheless, some points that could be improved in the future. First, the business project could have been better prepared in advance. Topics should have been created and communicated to students beforehand, so that a clear outline of what was expected could be a priori developed. This led to students not fully understanding what was expected of them, especially in the initial stages. Furthermore, there was a lack of alignment of what was expected with the Business Project from the academic and business advisors. They both had different output expectations, which increased the difficulty in providing both with the desired results. Even though a balance was achieved in the end, it would have been better if the company and university had previously discussed and aligned their expectations regarding the project.

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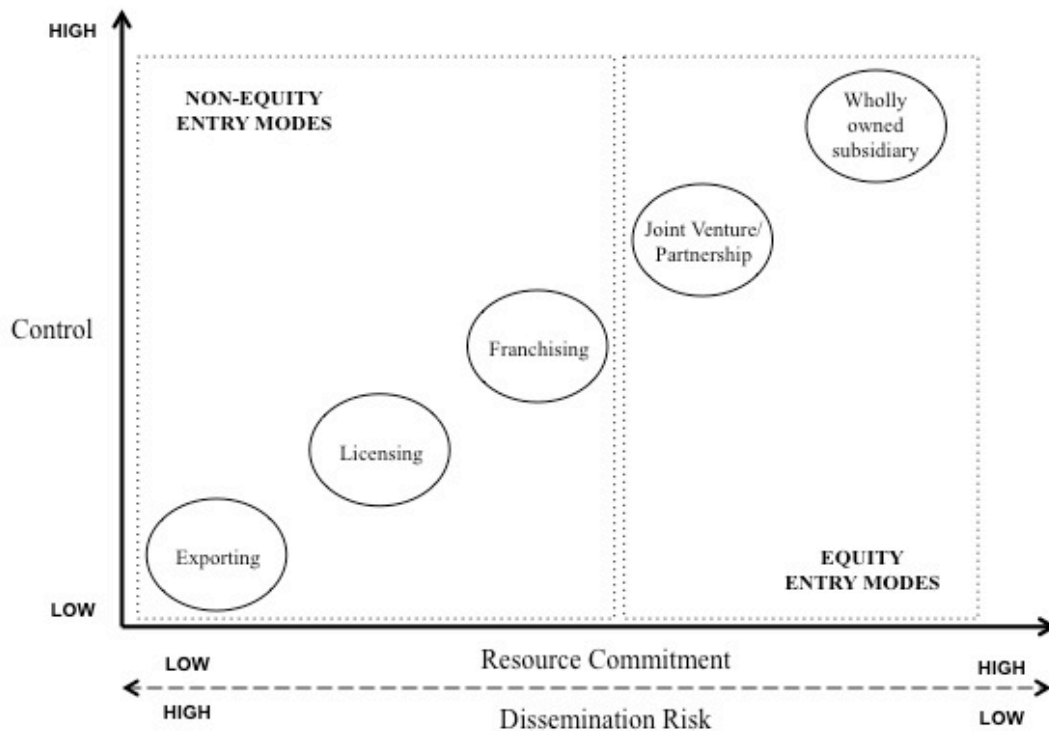
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5. Appendixes

Appendix 1 – Entry Mode Choice



Adapted from Hill, Hwang, & Kim (1990) and Kreikebaum, Gilbert, & Reinhardt (2002)

Appendix 2 – Cultural Comparison Between Austria and Czech Republic

